Mercantile Bank of Canada 1974 Annual Report

Financial Highlights

	1974	1973
Total assets	**$698,897,991**	*$587,244,104*
Total loans	**498,400,105**	*450,920,000*
Total revenue	**74,251,166**	*41,859,058*
Balance of revenue after provision for income taxes	**5,130,124**	*3,784,483*
Balance of profits for the year	**4,830,124**	*3,584,483*
Balance of profits per share, based on average shares outstanding	**83.5¢**	*84.4¢*
Average number of shares outstanding throughout year	**5,786,301**	*4,249,315*

A part of the mural made especially for Mercantile Bank's Montreal office by Jordi Bonet is shown on the cover of this report. It depicts the artist's impression of an aerial view of Eastern Canada.

Contents

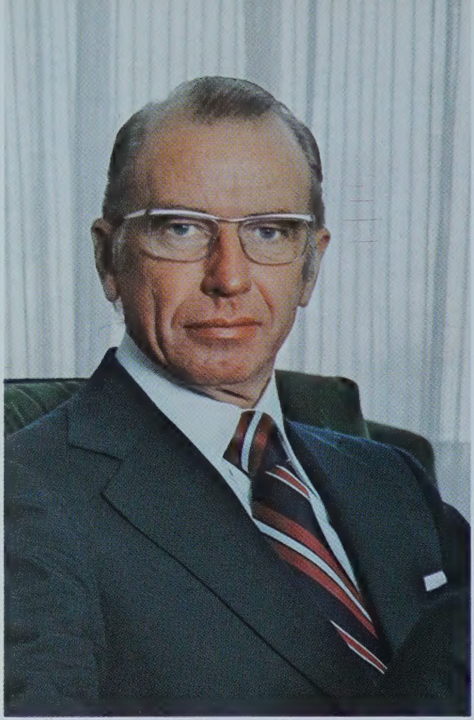
President's Address

I would like to echo Mr. Costanzo's remarks on the pleasure and appropriateness of our Meeting here today. As we are rather new in the Canadian market place, in relative terms, and with an expanding organization like ours, we feel it is important to afford shareholders and management the opportunity of meeting each other from time to time. As you may recall, last year's Annual Meeting was held in Toronto, and the one prior to that in Montreal. Thus, as of today, our Board and management have met many of our shareholders from east to west.

As you all know, our 1971 agreement with the Federal Government was essentially a commitment to become 75% Canadian owned by 1980. In this respect we have been gradually freeing ourselves from the leverage or growth restrictions in section 75 (2) (g) of the Bank Act. We set out to achieve this through a series of six rights issues of one million shares each. Already, four of these issues have been successfully completed and the fifth will be finalized next month, bringing Canadian ownership to 72.4%. During this period, when shares outstanding have tripled from two million to six million, Mercantile earnings have kept pace so that our earnings per share have met every expectation.

This increase in Canadian ownership means that Citibank's percentage of ownership is in the process of being reduced. Citibank will hold slightly less than 25% after the programme is finished. This decrease will not mean that our present policy of consulting with Citibank to obtain expertise, not otherwise available to us, will change. In my opinion, our management team, combined with that of Citibank's, affords our shareholders an optimum opportunity for solid development of the Bank.

I'll take a closer look at our earnings performance in a few minutes, but at this point I'd like to stress that during this period of high growth, one of management's prime concerns has been to achieve profitable growth — not simply asset growth. In the expanding economic climate such as we have had these past years, it has not been that difficult to develop lending opportunities; but our job is to see that any of our asset growth is accompanied by commensurate growth in profitability.



Paul H. Austin
President

G. A. Costanzo
Chairman

Mercantile's price/earning multiple is one of the highest in the industry, which we feel reflects the investors' view that we have been successful in our efforts and, as well, that for some time to come there is good asset and profit growth potential, without further share dilution, once the issue programme is completed.

Mercantile Bank continues to concentrate on the market segment of the banking business that we do best — corporate financing. In this respect, our average loan size tends to be larger than that of our competitors. Ninety-four per cent of our general loans are to well diversified industrial and commercial borrowers, with 89% of these loans over $1 million. The quality of our business is extremely high as measured by our loan loss ratio, which is less than last year's, and is under 1/10 of 1%, a level we consider low.

Equity markets, as all of us are aware, have been in a confused state for several months. This situation was obviously a key factor in our delaying the fifth rights issue which, on the basis of asset growth, could have been concluded last summer. However, management has not been marking time these past months while waiting for the opportune time to bring that issue to market. On the contrary, we have been developing business that would facilitate moving rapidly toward our sixth and final issue.

As I mentioned earlier, the number of shares outstanding in the last three years has increased from two million to six million. Our total equity account as of October 31, 1974, stands at $41.3 million, up from $13.1 million just three years ago and $34 million a year ago. When we finish the present issue programme, we will have more than $55 million in our equity account, enough to support additional new business for some time to come.

When we started down the road of expansion, in 1971, we identified several areas that would require constant management attention. First, we had to ensure that we maintained the high staff calibre that had become our trademark. Second, sources of funds to support our growth had to be further developed. Third, profitability had to be at high levels to compensate for dilution. Fourth, expenses had to be very tightly controlled, even to the extent of postponing the opening of offices in new locations if such expenditures would have had, in the short run, a significant adverse effect on our earnings. And finally we had to develop and follow a carefully structured new business plan by which we would gradually gain new clients, within acceptable risk guidelines and at a rate commensurate with our growth objectives. Strict monitoring of these critical areas is basically responsible for our success and the rapidity of our rights issues. Although it will not be long before we are free of growth restrictions and thus be able to act in an unobstructed manner, I would like to assure you that we shall continue to discipline ourselves in these major areas of management.

The economic climate in which we operated during the last fiscal year was by no means an easy one. As you are aware, this year was characterized by rapidly rising and high level interest rates. The cost of deposits used to fund our loans rose faster than the prime lending rate, and thus our average interest spreads narrowed. Despite this we were able to achieve a balance of revenue after provision for taxes of just over $5.1 million for the year. This represents a rise of 35.6% over the 1973 level, the highest in the industry. A major contributor to this increase in earnings was our income from fees and exchange, classified in our Statement as other operating revenue; this was up by 87% to $5.8 million. Our net interest income, interest revenue less interest cost, appears to be almost flat year over year; this is misleading, due to our increased income debenture investments. The yield on these instruments is low but the income is not taxable and they effectively give us a higher after-tax yield than on most of our other earning assets. If our net interest income were grossed up to reflect this, it would show a significant improvement.

In January of 1974, the fourth of the six rights issues took place. With this, the average number of shares outstanding during the year increased by 36.2%. Notwithstanding this high level of dilution, along with narrower interest spreads, on which I just commented, as well as the increased cost of doing business in an inflationary market, we were able to maintain earnings per share at virtually the same level as last year. In fact, if the effect of the retroactive 10% income tax surcharge were excluded, our earnings per share figure would have shown a slight increase. I think this earnings achievement under these circumstances is significant and augurs well for Mercantile's future.

One final comment on our rights issues; as mentioned earlier, number six is still ahead of us. With reasonable market conditions, we should wrap up the issue programme in fiscal 1975, approximately five years ahead of schedule!

We have drawn up our strategic action plans for 1975 and have structured them in such a way as to be able to adjust to today's uncertain economic situation. The short-term outlook presently is not bright. Most government and business leaders agree that we are now entering into, or are in, a world recession. I believe that Mercantile Bank, with its highly competent management team and tight management controls, has the ability to successfully cope with these uncertain conditions.

In this shifting economic environment, we are already witnessing a change in the trend of interest rates. It is probable that the falling rates we are experiencing, presently affected by a short-term upward technical movement, will continue for the first part of 1975 and should give us the opportunity to bring our loan spreads back to normal levels. Interestingly, our funding operations differ from the industry and thus a downward movement of interest rates tends to favour our earnings.

As shareholders you should be aware of some of the more important structural aspects that will affect our earnings per share in the coming years. First off: low leverage relative to industry standards. While the assets of our competitors tend to be around thirty times aggregate outstanding equity capital, we have been obliged by legislation to limit our assets to a maximum of twenty times authorized capital. After our sixth issue, this restriction will no longer apply. Second: we have not used any of our capabilities to create subordinated debt through the issue of debentures; and third, we have not maximized the formation of allowable tax free reserves. Thus, through better leverage opportunities once the issues are finalized, debenture potential used, and full utilization of allowable tax free reserves, we expect a period of undiluted growth with an accompanying improvement of earnings per share. I should point out here that, as we book new business, we will be following our return on assets closely, to ensure that we continue to surpass accepted industry norms, thereby utilizing our capital base to the maximum benefit of our shareholders.

I mentioned at last year's Meeting that we planned to open a few new branches in line with our policy of being represented in major commercial centres. Our Hamilton branch has been in operation since April 1974 and together with our Kitchener/Waterloo and Toronto branches we now have three offices in our Ontario Division. Just a few weeks ago, we opened a branch in Saint John, New Brunswick, bringing total branches in our Eastern Division to four. As well, our Western Division has good representation with four branches. In addition, I announced last year that we had just been granted permission to open a representative office in Los Angeles. Headed by a Canadian, and acting as Mercantile's representative, our first international office has now been in operation since May of this year. As far as further physical expansion is concerned, we have already identified another three sites for new branches in Canadian commercial centres where we are not yet represented, and shall act on these when conditions permit.

This fiscal year-end marked the Bank's fifth consecutive year of profitable operation. I am pleased to tell you that this record of profitability, together with the fact that during the last five years we have far exceeded the hurdle concerning the availability of funds for the payment of dividends, qualifies Mercantile Bank's shares as an eligible portfolio investment for institutions heretofore prevented from holding our shares except under special conditions. These institutions, such as insurance companies, trust companies and pension funds, were restricted by statute, except under the so-called basket clause, from holding any significant amount of our shares. This qualification is very important in that it could mean greater marketability of our shares as well as new sources of deposits for the Bank.

In closing I would like to reaffirm my confidence in Mercantile Bank's continued profit growth and performance in the future. This would of course be impossible without our fine staff; I would like to take this occasion to acknowledge their superb efforts on behalf of the Bank and, as well, to thank our clients who have given us the opportunity to service their financial needs.

Hamilton Branch

Focus on Mercantile Bank

LOCATIONS

During the past few years, since the 1971 agreement with the Federal Government concerning the method in which Mercantile would become a Canadian owned institution, we have followed a policy of gradual expansion of our centres of operation. In this respect, and with the goal of being represented in Canada's major commercial areas, the Bank has opened four branches during this period, bringing the present total to eleven. In September 1971, we expanded into the Northwest by opening in Edmonton. We augmented our service facilities in the province of Ontario, with new branches in Kitchener and Hamilton, and our latest opening was in Saint John, New Brunswick, in November 1974.

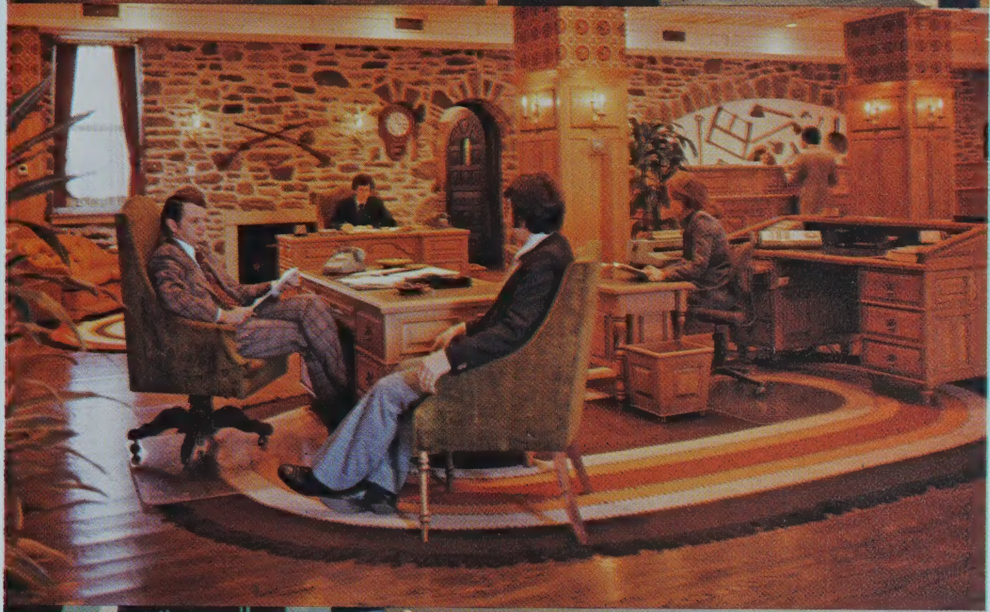
Given the increasing importance of north-south trade on the west coast of North America we have opened a representative office in Los Angeles. This new venture is meeting our expectations. Of course we have a very important international connection through First National City Bank of New York.

PEOPLE

Growth, in terms of locations or subsequent success in terms of results would not be possible without competent, hardworking staff. We are extremely proud of our 426 capable and resourceful men and women. With the constant change in the environment of the business world, management recognizes the

Calgary

Winnipeg



Quebec City

Vancouver

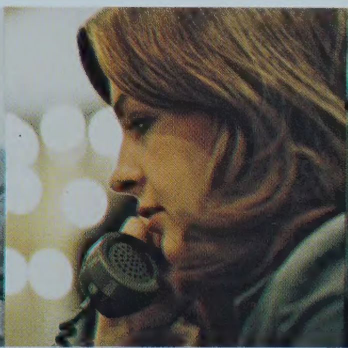
Toronto

need for continual educational programmes for our people, and has developed both internal and external training facilities to keep pace with these events.

SERVICES

While operating in nearly all of the major commercial centres of the country and offering a full range of banking services, our size gives us the benefits of short and direct lines of communication. We are able to enjoy the advantages of a close-knit team which is able to deal efficiently with the financial needs of our






GULF BIRD
GULF BIRD

clients. And yet at the same time, our connection with Citibank permits us to utilize superior expertise and experience gained over many years, throughout the world.

Although our major business efforts have been directed toward commercial activities, the chart below illustrates that we also offer consumer services. These are available at each of our locations. In addition we have established two special satellite offices in Halifax, primarily to service personal loans and residential mortgages. The residential mortgage field is in fact a new facet of our business commenced in early 1974.

Examples in the following pages illustrate how we at Mercantile Bank assist our clients in attaining their many and varied financial objectives.

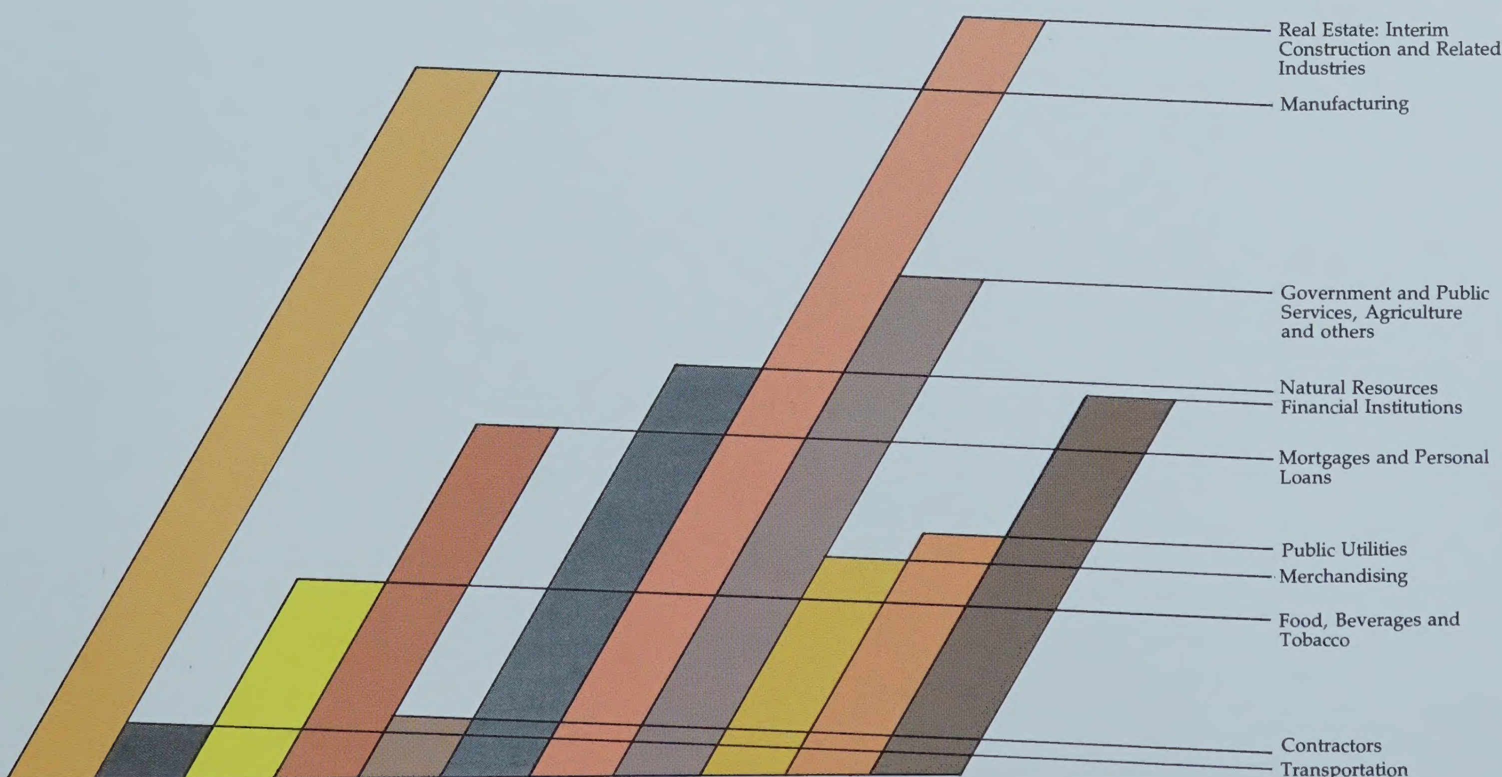
ACTIVITIES

The Gulf of Georgia Towing Company Limited, a well established company with Head Office in Vancouver, has contributed to the growth of British Columbia in many ways over the past sixty years. Not only has it served industry by transporting supplies such as fuel, limestone and lumber, but Gulf's fleet has also been involved in moving offshore oil rigs, in assisting in the construction of bridges and tunnels, and in towing rail barges on the Fraser River. Mercantile has acted as the company's bankers for several years. The extension of credit has enabled Gulf of Georgia to acquire profit producing assets for the expansion and continuation of its business.

A number of Mercantile's customers are in the business of real estate and its related industries. Wall & Redekop Corporation of Vancouver is one of these. In addition to many other projects, this company recently redeveloped Shannon Mews, an elegant estate first built in 1911. Mercantile, through the extension of a construction loan, enabled Wall & Redekop to successfully undertake the challenge of blending the old with the new in converting this property for modern-day living.

Gulf of Georgia Towing Company Limited

Mercantile's 1974 Loan Portfolio



Shannon Mews

CITV, Edmonton

Laiterie Laval Ltée is one of the largest processors and distributors of dairy products in the province of Quebec, servicing Quebec City and the eastern part of the province. This family enterprise, started around the turn of the century, has expanded very rapidly in the past ten years through acquisitions. The Bank provides Laiterie Laval Ltée with lines and term loans to finance expansion.

As well as assisting established companies in their growth plans, a bank can be of prime assistance in start-up situations. An example of this is Acadian Wholesalers Limited which was granted a credit line in 1968 to finance its receivables and inventory. Acadian has now become the largest wholesaler of toys and sundry merchandise in the Atlantic Provinces.

A more recent instance of our involvement with a new venture is CITV, a subsidiary of Allarco Developments Ltd. CITV is Edmonton's third English language and Western Canada's first independent television station. Mercantile Bank is providing term loans to finance the initial development in construction and equipment, as well as funds for operating requirements.

Unfortunately, events do not always occur as planned and unforeseen problems arise. In December 1973, a fire destroyed half of Crowe Foundry Limited's plant. The company had been manufacturing grey iron castings since 1953 in Cambridge, Ontario. We at Mercantile were able to help Crowe at this difficult time by financing a portion of the capital expenditure required to rebuild the facilities as well as expand them.

Another example of Mercantile's participation in real estate is the recently completed Convention Centre in Calgary. This is a large, modern, "all-under-one-roof" complex comprising, in addition to convention facilities, a hotel, museum, and shopping centre. Our Calgary office financed the construction of the hotel. Both interim and term financing have been provided by Mercantile to Les Jardins de Mérici Inc. of Quebec City, for the first phase of construction of its luxurious residential complex overlooking the St. Lawrence River and comprising four hundred and ninety-nine apartments. When fully completed the project will consist of one thousand condominium

Laiterie Laval Ltée

rowe Foundry

units and one thousand, three hundred apartments.

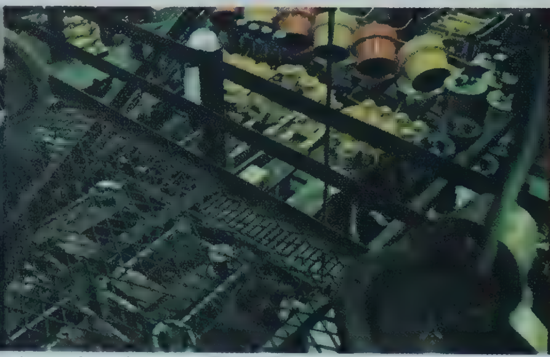
The Bank is playing its part, albeit small, in the realization of the James Bay hydro-electric project. We are extending financial support to a construction firm which has been awarded a contract for building the first dam.

Expansion has been important to Monarch Industries Limited of Winnipeg. Having commenced operations in 1935 in a basement, the company is now a leading manufacturer of pumps, hydraulic equipment and cement mixers and operates three plants in the Winnipeg area and one in the United States. Monarch has dealt with us since 1967 when we extended the company an operating line of credit for working capital purposes. More recently Monarch decided to expand again and we are now providing term financing to assist in the building of a new grey iron and ductile foundry and cement mixer/fabricating plant in Winkler, Manitoba.

A bank can be instrumental in supplying funds for company diversification. The acquisition of Gainers Limited by Agra Industries Limited was partially financed by Mercantile in 1972. Now we provide normal operating lines to this fully integrated meat processing and packing plant as well as some lines to finance substantial exports.

Financial assistance can be employed in many ways. The term loan that we are presently providing Blackwood Hodge (Canada) Limited is being primarily used to strengthen its debt structure. On a more tangible basis the demand loan we have extended is financing the sale of some large pieces of equipment. Blackwood Hodge is part of a

Calgary Convention Centre



Monarch Industries Limited

Gainers Limited

world-wide network involved in the distribution of heavy construction equipment and related machinery.

Carena-Bancorp Inc. is an investment company which owns, through a subsidiary, perhaps the most prestigious franchise in professional sport, the Montreal Canadiens. In addition to managing a portfolio of loans and leases, the company also owns the Montreal Forum and slightly less than 20% of IAC Limited. Through unconventional lending techniques, we have been able to assist this client in increasing its investment portfolio.

Carena-Bancorp Inc.


...wood Hodge (Canada) Limited


Les Jardins de Mérici Inc.

James Bay Project

An Analysis of the Bank's Operations

ASSETS

Total Assets, at $698,897,991, as of the end of October 1974 were up 19.0% from a year ago. This increase, while being satisfactory in itself, was held down due to a legal maximum permissible asset ceiling as outlined in section 75 (2) (g) of the Bank Act. The ceiling, at $700 million, will remain in force until the completion of the fifth in the series of six planned rights issues. Upon completion of this fifth issue the Bank's assets will be permitted to grow to $800 million. When the sixth issue is finalized and the Bank has completed its rights programme whereby Canadian residents will own 75% of the Bank, Mercantile will be free of any statutory growth restrictions. At this point, rates of growth will be dictated by market conditions and by Bank policies. Mercantile's assets reached the $700 million ceiling in August of this year; the fifth issue originally planned for mid-summer was delayed given equity market conditions. However, this was launched shortly after the close of the fiscal year, and further asset growth is expected after the issue is completed in January.

Mercantile Bank's loans grew by 10.5% to reach $498,400,105 at the end of the year. This increase was less than the 19.0% recorded for Total Assets, due to a change in asset mix. Given that the total assets were limited to a level below $700 million, as mentioned earlier, it was a management decision to allocate ~~scarce asset room to income debentures and income bonds.~~ Although the actual yield on these instruments is low, the income is not taxed in the hands of the Bank. The effective after-tax yield on these investments is generally greater than that on loans. These income debentures and income bonds are included in Other Securities which rose by $30,098,283 or 56.3% to $83,567,536. The majority, although not all, of the securities in this category are income debentures or income bonds. The remaining securities held by the Bank, including government securities which grew by 37.7% to $40,071,181, represent an increase in the Bank's liquidity. Total Loans accounted for 71.3% of the Bank's assets, a level below that of last year. However, if income debentures and income bonds, which are simply another form of business financing, are included in this ratio, over 80% of the Bank's assets would be in the form of commercial and industrial financing.

with these, get interest if these as profits these to give the firm ~~tax~~ yield on these lower also tax on income debentures

LIABILITIES

Total Deposits reached $620,459,651 at the end of the 1974 fiscal year, an increase of 18.8% over 1973. Deposit growth was slightly less than that for assets as a rights issue in January added approximately $7 million to the Bank's equity. As in past years, Mercantile relied on money market sources to fund the bulk of its assets.

PROFIT AND LOSS

Total Revenue for the year, at $74,251,166, grew by 77.4% from 1973, reflecting an increase in asset volume, a higher average prime rate, and improved exchange, fee and commission earnings. Looking at each item of revenue separately, Income from Loans rose by 67.6% to $60,570,599, due to a higher volume and to an increase of 343 basis points in the yield on loans. This increase in yield compares to a rise of 335 basis points in the unweighted average Canadian dollar prime rate between 1973 and 1974. Income from Securities grew by 200.6% to $7,875,458, largely as a result of generally higher rates and an increase in the volume of Other Securities including, of course, income debentures and income bonds. The growth of $2,705,371 in Other Operating Revenue reflects an improvement in foreign exchange income, fees on loans and other fees and commissions received for a variety of services rendered.

Net interest earnings (Income from Loans plus Income from Securities less Interest on Deposits) grew only marginally from 1973, by 0.7%, to $10,804,828 in 1974. Two factors accounted for this minimal increase. Firstly, interest on deposits grew by 105.6% to $57,641,229 compared to a growth in interest revenue of 76.6% as money market interest rates rose more rapidly than the prime lending rate. At several times during the year, money market costs actually exceeded the prime rate with a resultant unfavourable impact on yield-cost spreads and net interest earnings. The second factor, of even more significance than the first, concerns Income from Securities which included a large component of tax free revenue from corporate income debentures and income bonds. As explained earlier, because of the tax free nature of the earnings, these instruments carry a lower interest yield which had the effect of reducing net interest earnings. On a bottom line basis, however, income debenture and income bond revenue

generally increases after-tax Balance of Revenue, as compared to an equivalent volume of loans. If the tax free revenue were grossed up to a pre-tax equivalent, net interest earnings would have increased by about 20% instead of the 0.7% indicated above.

Non-interest expenses, that is, all expenses other than interest paid on deposits, increased by 31.9%, or $2,321,307, to $9,606,813 in 1974, as Mercantile was hit by the inflationary pressures that were evident throughout the Canadian economy in 1974. Salaries and related staff benefits accounted for a significant portion of the increase, rising by $1,016,335 to $4,448,788. The number of staff rose from 367 at the end of fiscal 1973 to 426 at the end of this year as the Bank's expanded operations required increased manpower. Also, industry-wide "cost of living" salary adjustments in the fall of 1973 and the spring of 1974 contributed significantly to the year over year increase in salaries and benefits.

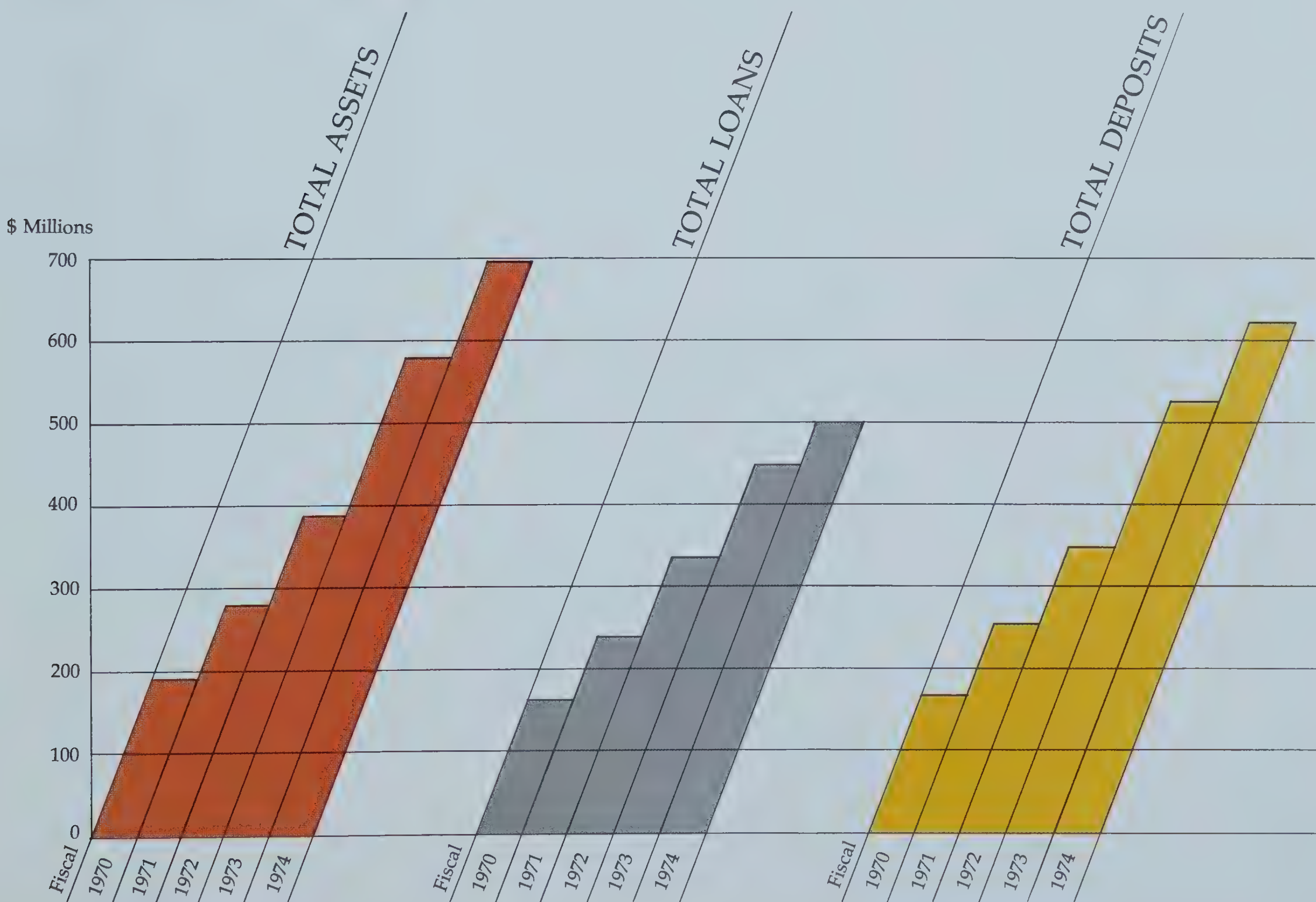
Property Expenses, at $1,642,455, increased by $386,116, or 30.7%, over last year's level, reflecting the costs of Mercantile's new branches in Kitchener/Waterloo and Hamilton, as well as general increases in property taxes, repairs, maintenance, servicing and depreciation expenses.

Other Operating Expenses at $3,515,570 grew by 35.4% in 1974. A number of items contributed to this advance. The provision for loan losses based on the five-year average loan loss experience was up only marginally from 1973 due largely to the increase in loan volume. The five-year loan loss as a per cent of loans was slightly below that of last year, at about one-tenth of one per cent. Travel expenses increased as a result of customer-related travel, staff relocations and transportation to Head Office for training programmes. The cost of stationery and supplies rose sharply as paper costs in particular were caught in the inflationary spiral. The opening of two new branches plus the representative office in Los Angeles also added to expenses as did communications, telephone, shareholders' information and business promotion expenses.

The Bank's Balance of Revenue grew by 7.1% to $7,003,124 in 1974 from $6,540,483 in 1973. This figure is misleading, however, due to the tax free nature of income debentures and income bonds. If Balance of Revenue were grossed-up for this factor, Balance of Revenue (before tax) growth would have paralleled the growth in Balance of Revenue after Provision for Income Taxes, as explained later in this section.

Provision for Income Taxes in 1974 compared with 1973 declined by 32.0% to $1,873,000. The effective tax rate was 26.7% in 1974 versus 42.1% last year. This year's provision included approximately $70,000 for the retroactive income tax surcharge imposed in the recent federal budget. The low effective tax rate results from the tax free revenue from income debentures and income bonds as mentioned previously.

Balance Sheet Highlights



Profit and Loss Highlights

Balance of Revenue after Provision for Income Taxes, the banking industry's closest equivalent to after-tax earnings, increased by 35.6% to $5,130,124 in 1974 from $3,784,483 in 1973. This growth rate in earnings favourably compares with the 19.0% increase in assets. On a per average share basis, Balance of Revenue after Provision for Income Taxes was 88.7¢ versus 89.1¢ in 1973. Excluding the retroactive federal corporate surcharge, Balance of Revenue, after Provision for Income Taxes, would actually have increased marginally. Average shares outstanding increased by 36.2% to 5,786,301 in 1974 from 4,249,315 in 1973 due to the rights issue of one million shares in January 1974. This 36.2% dilution was offset by the 35.6% growth in after-tax Balance of Revenue which allowed us to maintain earnings per share at approximately last year's level.

Appropriations for Losses, a provision made for unexpected loan loss, rose by 50.0% from $200,000 in 1973 to $300,000 in 1974 reflecting the increase in total loans outstanding. The total balance in this reserve account at the year-end was $3,088,656.

Mercantile Bank's Balance of Profits (Appropriations for Losses deducted from Balance of Revenue after Provision for Income Taxes) was $4,830,124 in 1974, representing an increase of 34.8% over 1973. Balance of Profit per average share outstanding was 83.5¢ in 1974 versus 84.4¢ in 1973.

Total dividends paid by the Bank in 1974 amounted to $4,493,332, an increase of $1,094,463 or 32.2% over last year's level. In 1973, dividends were paid on 4,000,000 shares during the first half of the year and 5,000,000 shares during the second half; in 1974, dividends were paid on 6,000,000 shares throughout the entire period. The regular dividend rate was 50¢ per share in both 1973 and 1974; however, the special dividend paid in the final quarter was increased to 25¢ per share in 1974 from 23¢ per share in the previous year. The total amount paid out in 1974 amounted to 93.0% of the Balance of Profits compared to the 94.8% pay-out in 1973.

PRODUCTIVITY

Mercantile's productivity suffered to some extent in 1974 due to the restriction in asset growth in the last part of the year resulting from the delay in marketing the fifth rights issue. However, the two ratios below indicate that performance remains excellent.

Mercantile's assets per employee at year-end amounted to $1,641,000 in 1974 versus $1,600,000 in 1973. The comparative all bank figures were approximately $777,000 and $678,000.

In terms of after-tax return on assets (Balance of Revenue after Provision for Income Taxes as a percentage of average month-end assets) Mercantile's ratio was 0.78% in 1974 compared with 0.77% in 1973. The equivalent estimates for the banking industry as a whole were 0.53% in 1974 and 0.60% in 1973.

Statement of Revenue, Expenses and Undivided Profits

For the Financial Year Ended October 31, 1974 (with comparative figures for 1973)

	1974	1973
Revenue:		
Income from loans	$60,570,599	$36,138,972
Income from securities	7,875,458	2,620,348
Other operating revenue	5,805,109	3,099,738
Total revenue	74,251,166	41,859,058
Expenses:		
Interest on deposits	57,641,229	28,033,069
Salaries, pension contributions and other benefits	4,448,788	3,432,453
Property expenses including depreciation	1,642,455	1,256,339
Other operating expenses, including provision for losses on loans based on five-year average loss experience	3,515,570	2,596,714
Total expenses	67,248,042	35,318,575
Balance of revenue	7,003,124	6,540,483
Provision for income taxes relating thereto (Note 2)	1,873,000	2,756,000
Balance of revenue after provision for income taxes	5,130,124	3,784,483
Appropriation for losses, net of income taxes related thereto (Note 2)	300,000	200,000
Balance of profits for the year	4,830,124	3,584,483
Dividends	4,493,332	3,398,869
Amount carried forward	336,792	185,614
Undivided profits at beginning of year	507,548	321,934
Undivided profits at end of year	$ 844,340	$ 507,548
Balance of profits per share based on average shares outstanding	83.5¢	84.4¢

See accompanying notes to financial statements.

Statement of Assets and Liabilities

as at October 31, 1974 (with comparative figures for 1973)

ASSETS	1974	1973
Cash and due from banks	$ 27,710,873	$ 14,417,706
Cheques and other items in transit, net	7,018,051	9,573,476
Total cash resources	34,728,924	23,991,182
Securities issued or guaranteed by Canada, at amortized value	39,571,588	25,934,195
Securities issued or guaranteed by provinces, at amortized value	499,593	3,168,429
Other securities, not exceeding market value	83,567,536	53,469,253
Total securities	123,638,717	82,571,877
Day, call and short loans to investment dealers and brokers, secured	10,000,000	14,850,000
Other loans, including mortgages, less provision for losses	488,400,105	436,070,000
Total loans	498,400,105	450,920,000
Bank premises, at cost, less amounts written off	2,426,178	1,772,181
Customers' liability under acceptances, guarantees and letters of credit as per contra	33,158,751	25,515,104
Other assets	6,545,316	2,473,760
	$698,897,991	$587,244,104

See accompanying notes to financial statements.

Paul H. Austin
President

Notes to Financial Statements

October 31, 1974

1. *By Order in Council dated February 23, 1971, the Government of Canada approved a special by-law increasing the authorized capital of the Bank from $10,000,000 to $40,000,000 in stages of $5,000,000 each. The first such increase became effective on the date of the Order in Council and each successive increase occurs only after the additional shares created by the previous increase have been offered to and subscribed for by, or otherwise disposed of to, residents of Canada in compliance with the Bank Act. Effective January 30, 1972, each issued or unissued share of the capital stock of the Bank of the par value of $10 each was subdivided into two shares of the par value of $5 each. On each of March 30, 1972, December 14, 1972, June 18, 1973, and January 18, 1974, the Bank completed the issue of an additional 1,000,000 shares of the par value of $5 each and consequently the authorized capital was increased on those dates in increments of $5,000,000 from $15,000,000 to $35,000,000. At November 22, 1974, the Bank is in the process of making the fifth such issue of an additional 1,000,000 shares to residents of Canada which, when completed, will have the effect of increasing the authorized capital to $40,000,000.*

2. *The aggregate provision for income taxes is made up as follows:*

	1974	*1973*
In respect of balance of revenue	**$1,873,000**	*$2,756,000*
In respect of current appropriations for losses (credit)	**(326,000)**	*(205,000)*
In respect of expenses of capital stock issues (Rest Account)	**(100,189)**	*(179,605)*
	$1,446,811	*$2,371,395*

LIABILITIES	1974	1973
Deposits by Canada	$ 2,838,639	*$ 4,114,700*
Deposits by provinces	3,114,001	*23,510,869*
Deposits by banks	67,699,855	*39,703,646*
Personal savings deposits, payable after notice in Canada in Canadian currency	7,995,192	*4,302,513*
Other deposits	538,811,964	*450,523,920*
Total deposits	620,459,651	*522,155,648*
Acceptances, guarantees and letters of credit	33,158,751	*25,515,104*
Other liabilities	940,293	*2,929,725*
Total liabilities	654,558,695	*550,600,477*
Accumulated appropriations for losses	3,088,656	*2,637,779*
SHAREHOLDERS' EQUITY:		
Capital (Note 1):		
Authorized—7,000,000 (1973—6,000,000) shares, par value $5 each; issued and fully paid—6,000,000 (1973—5,000,000) shares	30,000,000	*25,000,000*
Rest account	10,406,300	*8,498,300*
Undivided profits	844,340	*507,548*
Total shareholders' equity	41,250,640	*34,005,848*
	$698,897,991	*$587,244,104*

T. Sean Ahern
for Chief General Manager

Statement of Accumulated Appropriations for Losses

For the Financial Year Ended October 31, 1974 (with comparative figures for 1973)

	1974	1973
Accumulated appropriations at beginning of year:		
Tax-paid—from amounts not subject to income tax	$ 1,603	$ 1,603
General	2,636,176	2,278,751
Total	2,637,779	2,280,354
Add (deduct):		
Appropriation from current year's operations, net of income taxes related thereto as set out below	300,000	200,000
Provision for losses on loans based on five-year average loss experience (included in other operating expenses) less the loss experience on loans for the year	56,003	(19,323)
Profits and losses on securities, including provisions to reduce securities other than those of Canada and its provinces to values not exceeding market	(231,126)	(28,252)
Income tax credit related to appropriation from current year's operations	326,000	205,000
Accumulated appropriations at end of year	$ 3,088,656	$2,637,779
Tax-paid (amounts not subject to income tax)	$ 1,603	$ 1,603
General	3,087,053	2,636,176
	$ 3,088,656	$2,637,779

See accompanying notes to financial statements.

Statement of Rest Account

For the Financial Year Ended October 31, 1974 (with comparative figures for 1973)

	1974	1973
Balance at beginning of year	$ 8,498,300	$4,674,000
Premium on issuance of capital stock	2,000,000	4,000,000
Expenses of issue, net of income taxes relating thereto (Note 2)	(92,000)	(175,700)
	1,908,000	3,824,300
Balance at end of year	$10,406,300	$8,498,300

See accompanying notes to financial statements.

Auditors' Report to the Shareholders

We have examined the statement of assets and liabilities of The Mercantile Bank of Canada as at October 31, 1974 and the statements of revenue, expenses and undivided profits, accumulated appropriations for losses and rest account for the year ended on that date. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion, the foregoing statements present fairly the financial position of the Bank as at October 31, 1974 and the revenue, expenses, changes in individed profits, changes in accumulated appropriations for losses and transactions in the rest account of the Bank for the year ended on that date.

J. S. Grant, C.A.
of Peat, Marwick, Mitchell & Co.

J. F. Lewis, C.A.
of Thorne Riddell & Co.

Montreal, Quebec
November 22, 1974

Twenty-first Annual General Meeting of the Shareholders

MINUTES of the Twenty-First Annual General Meeting of the Shareholders of The Mercantile Bank of Canada held at the Hyatt Regency, Vancouver, on Thursday, the 12th day of December, 1974, at 10:00 o'clock of the forenoon.

The Chairman of the Bank, Mr. G. A. Costanzo, presided and the Secretary, Mr. G. S. Lynch, acted as Secretary of the Meeting. In opening the Meeting, the Chairman said —

"Having been elected as Chairman last year, it is indeed my pleasure to officiate for the first time at the Bank's Annual General Meeting. I am all the more delighted that it is being held this year here in Vancouver, giving you, our Shareholders in the West, the opportunity to meet and talk with members of our organization. We at Mercantile are conscious of the high growth in the number of our Shareholders as a result of our share issues over the last few years. As of October 1974 we had some 6,000 Shareholders. This compares with 2,819 two years earlier at the end of our 1972 fiscal year. Thus in just two years the number of our Shareholders has grown by 113%. We hope that by holding our Meetings in different cities we will give the growing number of our Shareholders a chance to become acquainted with us."

The notice of the Meeting having been sent to all Shareholders entitled to receive it and a quorum being reported present, the Chairman declared the Meeting to be duly convened and constituted.

With the consent of the Meeting, the Chairman appointed Mr. S. G. Hart and Mr. T. M. Birch, both of The Royal Trust Company, to act as Scrutineers.

Upon motion of Mr. A. Bachand, seconded by Mr. H. T. Mitchell and carried, the Minutes of the last Annual Meeting held on January 10, 1974, were taken as read and confirmed.

The Chairman then asked the Secretary to read the Directors' Report to the Shareholders, omitting the Annual Statement and the Auditors' Report as these had already been sent to all Shareholders and copies were in the hands of those present.

DIRECTORS' REPORT

The Directors take pleasure in submitting to the Shareholders the Annual Statement of the Bank for the year ended October 31, 1974, together with the Auditors' Report.

The programme of periodic stock issues is continuing. The fourth such issue was completed last January and the fifth issue, announced in November, will be completed toward the end of January at which time the limit imposed by the Bank Act on the size of the Bank's assets will be increased to $800,000,000. It is hoped that market conditions will make it possible to complete the sixth and final issue in this programme, freeing the Bank completely from the statutory restrictions on its growth, by the middle of 1975.

The number of branches has been increased to eleven by the opening of one at Hamilton in April and one at Saint John in November. The opening of branches at other important cities where the Bank is not represented will be proceeded with as circumstances permit.

With much regret, the Directors report that Mr. J. L. Black, who has been a Director of the Bank since 1963, will not stand for re-election this year. Mr. Black's devoted interest in the Bank's affairs and his wise counsel have been much appreciated; he will be greatly missed.

The loyal and efficient services of the staff are gratefully and sincerely acknowledged.

(Signed) G. A. Costanzo
Chairman

Montreal, December 12, 1974.

The Chairman said that before moving the adoption of the Directors' Report he would ask the President to address the Meeting. (The President's address is reproduced on pages four and five.)

It was moved by the Chairman and seconded by Mr. H. A. Benham —

THAT the Directors' Report to the Shareholders, including the Annual Statement and the Auditors' Report thereon, in respect of the Bank's fiscal year ended October 31, 1974, be and the same is hereby approved and adopted.

The Chairman proposed that the ballot on this motion be taken later in the Meeting.

AUDITORS

It was moved by Mr. H. H. Stikeman and seconded by Mr. J. H. Taylor —

THAT Mr. John S. Grant, C.A. and Mr. John F. Lewis, C.A. be appointed auditors of the Bank for the current year and that their remuneration in that capacity be not more than $40,000.

The Chairman proposed that the ballot on this motion be taken later in the Meeting.

DIRECTORS

In proposing that the election of Directors be proceeded with, the Chairman said —

"During the year, Mr. W. B. Wriston, one of Citibank's two representatives on the Board, resigned and was replaced by Mr. C. W. Desch. As you have learned from the Directors' Report, Mr. J. L. Black will not stand for re-election. Otherwise, the present Directors are proposed to you for re-election. Pursuant to Shareholders' By-Law IV, the number of Directors has been reduced from fifteen to fourteen effective at this election."

At the Chairman's request, the Secretary then read the names of the persons proposed for election as Directors, namely: P. H. Austin, A. Bachand, H. A. Benham, G. A. Costanzo, C. W. Desch, L. P. Gélinas, J. T. Johnson, H. T. Mitchell, A. T. Seedhouse, R. D. Southern, H. A. Steinberg, H. H. Stikeman, J. H. Taylor, E. D. H. Wilkinson.

Mr. J. L. Black then nominated the persons whose names had been read by the Secretary for election as Directors of the Bank for the ensuing year.

The Chairman then directed that a ballot be taken on the motions to adopt the Directors' Report, to appoint Auditors and for the election of Directors. Upon receiving the report of the Scrutineers, the Chairman declared that the resolutions adopting the Directors' Report and appointing Auditors had been duly passed and that the persons whose names had been read by the Secretary, and duly nominated, had been elected Directors.

The Meeting then terminated.

G. A. Costanzo
Chairman

G. S. Lynch
Secretary

At the subsequent meeting of the Board of Directors the following officers were elected:

Chairman, G. A. Costanzo; President and Chief Executive Officer, P. H. Austin; Vice Presidents, L. P. Gélinas and A. T. Seedhouse.

Board of Directors and Executive Officers

DIRECTORS

G. A. Costanzo
Chairman

Paul H. Austin
President and Chief Executive Officer

Hon. Louis P. Gélinas
Vice President

Alfred T. Seedhouse
Vice President

André Bachand
Director,
Development Fund,
University of Montreal

Hugh A. Benham, LL.D.
Executive Director,
The Winnipeg Foundation

Carl W. Desch
Senior Vice President and Cashier,
First National City Bank

John T. Johnson, Q.C.
Partner,
Borden & Elliot

Howard T. Mitchell
President,
Mitchell Press Limited

Ronald D. Southern
President and Chief
Executive Officer,
Atco Industries Ltd.

H. Arnold Steinberg
Executive Vice President,
Administration and Finance,
Steinberg's Limited

H. Heward Stikeman, Q.C.
Senior Partner,
Stikeman, Elliott, Tamaki,
Mercier & Robb

John H. Taylor
Chairman,
North American Life
Assurance Company

Edward D. H. Wilkinson, Q.C.
Partner,
Russell & DuMoulin

OFFICERS

Duncan Campbell
Senior Vice President,
Western Division

John E. Pierce
Senior Vice President,
Eastern Division

Walter A. Prisco
Senior Vice President,
Ontario Division

L. Linton Reid
Vice President and General Manager,
Investment and Exchange

B. Jean Goyette
Vice President,
Investment and Exchange

T. Sean Ahern
General Manager and
Chief Accountant

Harold F. Henry
General Manager —
Credit

James S. Parsons
Deputy General Manager —
Mortgage and Real Estate

G. Stevens Lynch
Deputy General Manager and
Secretary

John E. G. Morris
Chief Inspector

William T. Livingstone
General Manager —
Personnel and Public
Relations

Raymond M. Roy
Deputy General Manager —
Training and Development

Head Office and Branches

HEAD OFFICE

625 Dorchester Boulevard West
Montreal, Quebec H3B 1R3

BRANCHES

EASTERN DIVISION

Montreal Branch 625 Dorchester Blvd. West	Dennis L. Frizzell, Vice President
Quebec City Branch 580 Grande Allée East	Gilles Séguin, Vice President
Halifax Branch 1681 Granville Street	Jean G. Fournet, Vice President
Saint John Branch, N.B. 2 King Street	Gilles P. Grenier, Vice President

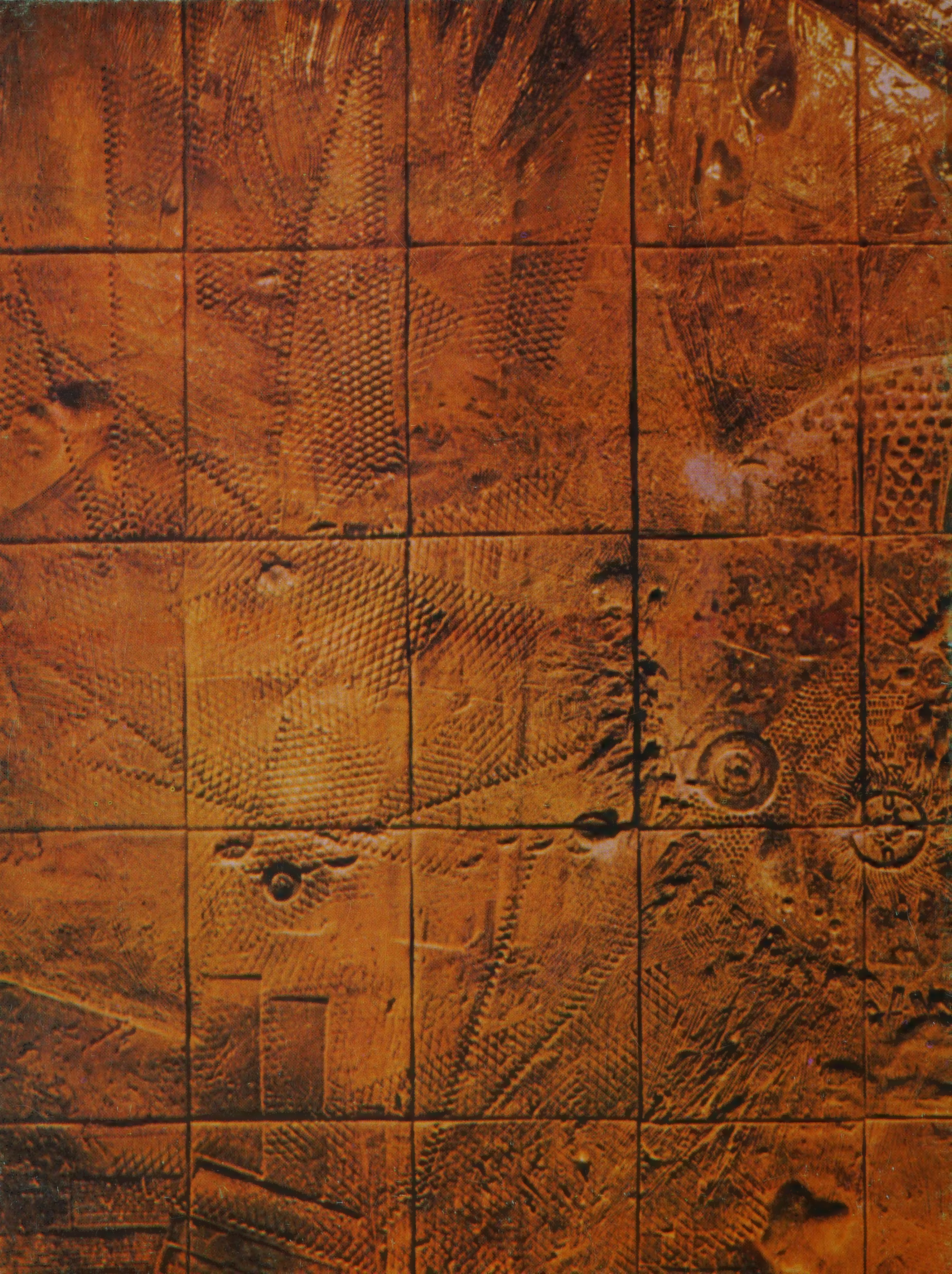
ONTARIO DIVISION

Toronto Branch 120 Adelaide Street West	Geoffrey D. Farrar, Vice President
Kitchener Branch 22 Frederick Street	James A. W. Van Slyck, Vice President
Hamilton Branch 47 James Street South	Alan J. Pyle, Manager

WESTERN DIVISION

Vancouver Branch 1177 West Hastings Street	Brian McL. Romer, Vice President
Calgary Branch 441, 5th Avenue, S.W.	Hermann G. Bessert, Vice President
Edmonton Branch 10030 Jasper Avenue	John R. Groves, Vice President
Winnipeg Branch 305 Broadway Avenue	Maurice M. Christens, Vice President

Los Angeles Representative Office 515 South Flower Street	Lloyd M. Craig, Representative



HEAD OFFICE

625 Dorchester Boulevard West
Montreal, Quebec H3B 1R3

WESTERN DIVISION

John E. Cleghorn
Vice President
Vancouver

Vancouver: 1177 West Hastings Street	Brian McL. Romer, *Manager*
Calgary: 441, 5th Avenue, S.W.	Peter Hewlett, *Manager*
Edmonton: 10030 Jasper Avenue	John R. Groves, *Manager*
Winnipeg: 305 Broadway Avenue	Maurice M. Christens, *Manager*
Los Angeles Representative Office: 515 South Flower Street	Lloyd Craig, *Representative*

ONTARIO DIVISION

Duncan Campbell
Vice President
Toronto

Toronto: 120 Adelaide Street West	Geoffrey D. Farrar, *Manager*
Kitchener: 22 Frederick Street	James A.W. Van Slyck, *Manager*
Hamilton: 47 James Street South	Hermann G. Bessert, *Manager*

EASTERN DIVISION

Walter A. Prisco
Vice President
Montreal

Montreal: 625 Dorchester Blvd. West	John E. Pierce, *Manager*
Quebec City: 580 Grande Allée East	Gilles Seguin, *Manager*
Halifax: 1 Sackville Place	Jean G. Fournet, *Manager*

Mercantile Bank of Canada

AR50

Affiliated with First National City Bank

INTERIM REPORT FOR THE SIX MONTHS ENDED APRIL 30, 1974

Report to Shareholders

During the first six months of the 1974 fiscal year, the Bank's Balance of Revenue After Taxes grew to $2,406,606, an increase of 51.9% over the level recorded a year earlier. Total Revenue, at $32,690,676, increased by 90.8% while Total Expenses, at $29,042,070, increased by 105.3% over the first six months of 1973. This latter increase was due largely to increased interest costs for deposits.

Balance of Revenue After Provision for Income Taxes amounted to 43.2 cents per share during the six month period on average shares outstanding of 5,569,061 versus 42.2 cents per share last year when the average number of shares outstanding for the six month period was 3,756,906. The regular quarterly dividend of 12.5 cents per share was declared in April bringing the total dividends per share declared for the first half of the year to 25 cents.

Comparing Total Assets, they continued to grow steadily reaching $661.7 million at the end of April 1974, 33.9% above the level of a year ago. Total Loans increased by 15.0% to $491.3 million as at the end of April and Total Deposits increased by 32.1% to $582.7 million as at the same date.

Two other important factors contributing to the increase in earnings, during this six month period of high deposit costs, were Income from Securities which increased by 194.5% to $2,417,129 and Other Operating Revenue which grew 90.1% to $2,342,206.

Paul H. Austin,
President

Statement of Revenue and Expenses

For the six months ended April 30, 1974 (Unaudited)

	1974	1973
REVENUE:		
Income from loans	$27,931,341	$15,080,355
Income from securities	2,417,129	820,739
Other operating revenue	2,342,206	1,232,081
Total revenue	32,690,676	17,133,175
EXPENSES:		
Interest on deposits	24,631,362	10,778,745
Salaries, pension contributions and other benefits	2,042,433	1,569,026
Property expenses, including depreciation	701,396	620,488
Other operating expenses including provision for losses on loans based on estimated five-year average loss experience	1,666,879	1,178,685
Total expenses	29,042,070	14,146,944
Balance of revenue	3,648,606	2,986,231
Provision for income taxes relating thereto	1,242,000	1,402,000
Balance of revenue after provision for income taxes (Note 1)	$ 2,406,606	$ 1,584,231
Balance of revenue per share based on average shares outstanding (Note 2)	43.2¢	42.2¢
Dividends declared in the period	$ 1,494,875	$ 999,250
Per share (Note 2)	25.0¢	25.0¢

NOTES

1 No provision has been made for transfer to accumulated appropriations for loss. The amount of the transfer can be determined only at the end of the financial year.

2 During the first quarter of 1974, an additional 1,000,000 shares were issued, bringing the total number of shares outstanding to 6,000,000. (Average shares outstanding: 1974 – 5,569,061 shares; 1973 – 3,756,906 shares.)

Balance Sheet Highlights

Unaudited (in thousands of dollars)

	April 30 1974	April 30 1973
Total assets	$ 661,680	$ 494,195
Total loans	491,263	427,102
Total deposits	582,700	441,265